CHASE

# International Finance

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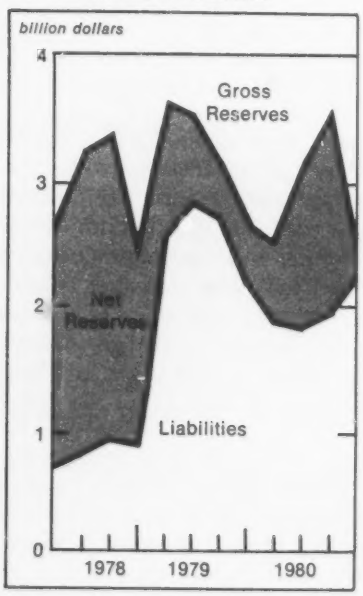
## Weakening Chinese Trade Position Prompts Austerity

Although China's trade deficit with the West narrowed to $1.3 billion last year from $2.0 billion in 1979, its trade position deteriorated over the course of the year. China's trade showing was strong in the first half of 1980, owing mainly to high world prices for its oil exports, but a surge in imports and depressed export earnings in the second half brought steady deterioration to the trade accounts. The weakness has continued in 1981, with the trade balance for the first quarter in deficit by $600 million.

The adverse shift in China's trade balance in the second half of 1980 created financing problems for the Chinese authorities. Unanticipated short-term financing needs associated with the fast growth in imports prompted a $275-million drawdown from the IMF and a decline of some $1.3 billion in China's net position with international banks in the final quarter of last year. The IMF was called upon again in early 1981 for another $565 million.

China's reserve position with Western banks




The shift in China's external accounts and in the financing outlook led the authorities to cancel several large foreign contracts. It also prompted China's Vice Premier to unveil a restrictive budget that proposes to reduce capital investment expenditure and to cut spending by administrative organizations and the military. (The cuts in centralized investment will be partly offset by increased investment by some provinces and municipalities.)

The outlook for 1981 and 1982 is for larger trade deficits—averaging $2 billion each year. The slowdown in worldwide trade will constrain export growth, while domestic production problems are expected to reduce the volume of oil exports and limit the growth of coal exports. Recent delays in negotiating contracts for exploratory drilling mean that additional earnings from oil exports will probably not appear before the late 1980s. On the import side, the need for agricultural goods, fertilizer, steel products, and machinery is likely to increase steadily.

Should China's trade deficit with the West continue to expand in the next several years, ample funding will be available from foreign official sources and from the international capital markets. Furthermore, despite the decline in China's reserves at end-1980, reserves still exceed liabilities to international banks. The recent shifts in Chinese policy with respect to capital investment and foreign projects, however, may discourage both long-term financing by banks and joint ventures with foreign firms. Greater reliance upon short-term counter trade, equipment contracts, and official export credits is highly probable over the next two years.

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*New Socialist government reflating French economy.*

France's new Socialist government is pressing ahead with its economic program. A 10% increase in the minimum wage was instituted June 1, and substantial rises in social welfare payments took effect July 1. The combined cost of these social welfare increases is estimated at 9 billion francs. A series of measures that boost spending on housing, jobs, and industrial investment was also announced. Soft loan facilities to depressed sectors of industry will be extended to side-step the increase in the cost of credit resulting from moves to protect the franc. And aid will be stepped up to help reduce youth unemployment, with the objective of providing jobs for 650,000 graduates in the fall. To help finance these measures, 6.8 billion francs will be raised in supplementary taxes. A new "super tax" on higher incomes will be introduced, along with a windfall profits tax on banks and oil companies and a higher rate of value-added tax on luxury goods. The consensus among private forecasters is that the new economic program will result in real GDP growth of 4%-5% in 1982. This compares with the expectation of zero real economic growth in 1981. Faster growth next year, however, is likely to be achieved only at the cost of 15% inflation and a current-account deficit of 70-100 billion francs. Currently, industrial production is 8% below its year-ago level, inflation is running at 12.7%, and the seasonally adjusted current-account deficit was 10.1 billion francs in the first quarter.

*Denmark's GNP will contract again this year.*

Denmark is showing gradual improvement in its economic position. Recent wage settlements have come in well below the rate of inflation, bringing with them a decline in the purchasing power of domestic consumers. Real consumers' expenditure dropped by 3½% in 1980 and is expected to fall and additional 1½% this year. Fixed investment has also declined, and, as a result, GNP is expected to contract by ½% this year after dropping 1% in 1980. The economic slowdown has benefited the external accounts. The 1981 current account is expected to stabilize at about 14 billion kroner, with the trade balance likely to improve over the course of the year. The trade balance for the first five months of 1981 shows a kr. 5.32-billion deficit, as against a kr. 7.56-billion deficit in the year-earlier period. Inflation is also expected to improve slightly, with the price index likely to advance 9½% after a 10¾% climb in 1980. These improvements, however, have been bought at the expense of rising unemployment. The rate of unemployment averaged 6.9% last year and is expected to average 8.5% this year. This will increase the pressure on the government to reflate the economy and could thereby reverse some of the earlier economic gains.

*Greek Cypriot economy departs from fast-growth track.*

Real economic growth in the Greek Cypriot economy slowed to 4.9% last year from 7.3% in 1979. The slowdown ended a pattern of remarkable real economic growth (over 14%, on an annual average basis) that continued from 1975 through 1979—which constituted a pronounced recovery from the 1974 Turkish invasion and partition of Cyprus. But in 1980, higher oil prices and signs of production capacity constraints boosted inflation and widened the current-account deficit to $245 million from $205 million in 1979. This prompted a tightening of economic policy in the second half of 1980 and marked the beginning of a "growth recession". While the post-invasion reconstruction phase is now over and lower growth rates than in 1975-79 will likely prevail, much depends on the policies of the new government elected in May.

*Strong import demands expanding Mexico's trade deficit.*

Mexico's trade deficit for the first quarter of 1981 was more than double its year-earlier shortfall. The annualized deficit was $1.8 billion in January-March 1981, compared with an annualized deficit of $0.8 billion recorded in the first quarter of 1980. Exports increased rapidly enough in the first quarter, led by a 92% gain in petroleum sales. But large demands for industrial raw materials and capital goods caused imports to outpace exports. The total deficit for 1981 will ultimately depend on the price and volume of Mexican oil exports, which now

account for three-fourths of total exports. But pricing policies are uncertain, with a markdown in prices followed by a decision to reverse some of the decline. Acknowledging the fundamental stability of oil prices and the likelihood of continued strong import needs, a 1981 trade deficit equivalent to or slightly larger than the $3.26-billion deficit recorded last year is expected.

*Dominican Republic pursuing restrictive policies to check current-account deterioration.*

The Dominican Republic's current-account deficit widened to $800 million in 1980 from an average $300 million in 1978 and 1979, but the pursuit of restrictive demand-management policies promises some improvement in 1981. The central government budget has been in virtual balance for the first five months of this year, in contrast to a deficit equal to 3% of GDP for 1980 as a whole. During the same period, the money supply showed no growth from its year-earlier level. Furthermore, the authorities have channeled more transactions to the parallel market and imposed additional import restrictions. These include banning motor vehicle imports for one year, establishing a quota system for industrial raw material imports, and limiting the amount of foreign exchange that the state food marketing agency can obtain at the official rate. Taken together, these measures are likely to permit a small narrowing in the 1981 current-account gap to $650-$700 million.

*Rapid economic growth in Australia coupled with widening current-account gap.*

Australian economic growth has been stronger than expected. For fiscal 1980-81, ended June 30, real growth is estimated at 4.7%—the highest in nine years. At the same time, the current account is firmly in deficit, with the shortfall estimated at over $4.8 billion in 1980-81. An adverse current-account showing is likely to continue in the near future, owing to the likelihood of weak export growth and commodity prices and no moderation of imports or in the invisibles deficit. The current-account outlook, however, does not presage a weakening Australian dollar. Capital inflows will more than cover the current-account deficits, and the overall balance for fiscal 1980-81 is likely to show a surplus of some $1 billion. As long as such fundamental incentives for capital inflows as resource potential and interest differentials persist—which is likely—the Australian currency will remain strong.

*Angolan economy recovering steadily, paced by oil output and exploration.*

The Angolan economy is steadily progressing in its recovery from the contraction that followed the 1974-75 civil war. The vital petroleum sector has already restored oil output to its pre-war level of 160,000 barrels per day, and OPEC membership is envisioned for next year. Diamond production is also rising rapidly, with a pre-independence output level of 2.2 million carats forecast for 1983. More importantly, the liberal investment code and sound economic management policies of the government are attracting increasing numbers of foreign firms—particularly to uncover new oil reserves. While economic data are incomplete, it is estimated that Angola enjoyed double-digit real economic growth in the 1978-80 period. The current account is believed to have registered a $575-million surplus last year, with this year's surplus projected at $425 million. Assuming political stability in southern Africa, Angola's economy could be poised for a take-off over the medium term.

*Rice production up, but consumption still exceeding output.*

World rice production is estimated at a record 265 million tons (milled basis) for the 1980-81 crop year, up 4.4% from 1979-80. The increase occurred despite major crop losses attributed to exceptionally cold weather in Japan and South Korea; record output in India, Bangladesh, Thailand, Burma, and Indonesia more than made up the difference. Nevertheless, rice consumption continues to exceed production, although by only a small margin. Carryover stocks will therefore remain low. Favorable weather conditions in the areas that enjoyed record production in 1980-81 imply a modest further increase in world rice production in 1981-82. If the expected crop materializes next year, world production should be approximately in line with consumption.

# Inflation Easing: But for How Long?

The Consumer Price Index rose only 0.7% in May, bringing the year-over-year rate of price increase below the 10% level for the first time since February 1979. The sharpest price declines of late have shown up in commodity prices, with the Dow Jones spot index currently 15% below its year-earlier level. But while there are indications that the rate of price rise will slow further in the coming months, it is much too early to declare final victory in the battle on inflation.

Some economists have noted that the improvement in inflation evident recently is normal for this stage of a business cycle. They argue that wage demands moderate slowly in response to the higher unemployment generated during a recession, and that the upturn in productivity in the early stages of a recovery further eases labor cost pressures. And they note that now, as in 1976 (a post-recession year during which the CPI rose only 5% versus a 12% climb in 1974), food price increases are small, and energy prices are soft. This time around, however, added help in curbing inflation is coming from smaller house price rises and a strong dollar.

It is perhaps more useful to focus on the role that restrictive monetary policy has played in damping inflation. First, it has abetted the cyclical improvement in productivity. At the end of a recession—the present circumstance—actual inflation is below expected inflation. Consequently, previously contracted for nominal wages are more costly to employers. To be able to pay this higher real wage, employers strive either to induce higher productivity or reduce the labor content of a unit of output.

Second, the higher interest rates that have resulted from the Federal Reserve's shift to an aggregates targeting policy have also reduced inflationary pressures. Interest carrying costs have reinforced the liquidation of cattle herds, which has eased beef prices; higher interest costs have also reduced prices of agricultural products and commodities in general. And with the cost of financing a house having risen sharply, it is no surprise that house prices have moderated. Moreover, large real interest-rate differentials have kept the U.S. dollar strong, reducing import costs and moderating pressures for a higher dollar-denominated oil price. But if not for the overall restrictiveness of monetary policy, relative price declines in these areas would have been accompanied by relative price increases of other goods.

The impact of past and current monetary restraint can be expected to linger at least until the end of 1982. But additional gains in reducing inflation depend upon further tightening of monetary policy, which has not occurred at this stage of previous expansions. It is vital, therefore, for the Reagan administration and Congress to support the Federal Reserve in its resolve to maintain its restrictive stance.



# The Sticky Funds Rate

Money growth has decelerated significantly in the last two months. From April 22 to June 17, seasonally adjusted M1-B actually fell by almost $8 billion. This drop has offset to a large extent the bulge in M1-B growth in the March/April period that many analysts believe was a major catalyst for the Federal Reserve's subsequent credit-tightening moves.

Somewhat surprisingly, however, the federal funds rate has not really come down in response to the sharp decline in money growth. Generally, when money growth runs below target, Fed actions designed to bring money growth back on target result in a decline in the federal funds rate—although with some lag.

There are several possible explanations for this somewhat uncharacteristic behavior. One is that while the narrowly defined money measures have fallen below target, the broader monetary measures—M2 and M3—are still above their longer-run growth targets. For example, M1-B is below the lower bound of its target growth range, especially after being adjusted for the effect of the expansion of NOW accounts this year. In contrast, M2 is slightly above and M3 is quite a bit above the upper bounds of their respective long-run target ranges.

Another possible reason is that the Federal Reserve may be pursuing an asymmetrical policy; that is, it may currently be less willing to tolerate excessive money growth than weak money growth. The Fed may be concerned that in the absence of a significant slowdown in total spending, a resurgence in money growth later this year is probable, especially if money-market rates fall sharply in the near term. This in turn might necessitate sharp credit-tightening moves later in the year.

Yet another possible reason is that while M1-B growth has been weak, short-term business credit demands have been quite strong. Large tax-related borrowings around June 15, and perhaps end-of-quarter borrowings related to balance-sheet window dressing, have recently contributed to this strength.

Finally, the time lag between a slowdown in money growth and a downward movement in money market rates is not constant. Indeed, the federal funds rate has at times remained high for several weeks after the Fed has altered its reserves targets in a manner usually consistent with a declining funds rate.

Identifying the specific reasons for a continued high federal funds rate is difficult. This is in large part due to the lack of information the Federal Reserve provides the public regarding its short-run targets for the money supply and bank reserves and the relative weights it attaches to the behavior of the various monetary measures in making policy decisions. Barring a near-term sharp jump in the money supply, however, past experience suggests that some downward pressure on the funds rate is likely over the next few weeks.

## Africa and Middle East Bimonthly Survey of Business and Finance

| | COUNTRIES | CURRENT BUSINESS CONDITIONS | EXPORTS: 6 months ending | EXPORTS: change from year earlier | GNP IN 1980: in billions of dollars | GNP IN 1980: per capita | BALANCE OF PAYMENTS: latest data | reserves (less gold) in million $ | 12-month change | months of imports covered | use of IMF credit, millions of dollars | current influences on payments | MONEY AND BANKING: 12-month changes: latest data | consumer prices | latest data | money supply(M1) | exchange rate in U.S. dollars June 30, 1981 | change from year earlier | current monetary conditions | COUNTRIES |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Africa | Algeria | Japanese consortium to build $270-million LPG plant; Arzew LNG-2 plant nearing completion. | Feb. | + 19% | 29.0* | $1,525 | Apr. | 3,837 | + 16% | 4.9 | 0 | Oil output holding steady at 900,000 bpd. | Dec. '79 | + 12% | Nov. | + 20% | .2355 | −14% | Net foreign assets as of end-1980 up 30% from 1979. | Algeria |
| | Egypt | Budget surplus of $381 million officially projected for 1981-82, versus $313 million in 1980-81. | Oct. | + 53% | 16.4* | 400 | Dec. | 1,046 | + 98% | 3.4 | 140 | Oil output averaged 595,000 bpd in 1980, up 13% from 1979. | Nov. | + 19% | Nov. | + 24% | 1.45 | 0 | IDA lends $56 million for water supply project. | Egypt |
| | Guinea-Conakry | Markets formerly state-controlled being opened to private sector. | Dec. | + 11% | 1.5 | 270 | n. a. | — | — | — | — | Tourism to be bolstered by building program for 1983 OAU conference. | n. a | — | — | — | .0600 | n. a. | New currency to be introduced soon. | Guinea-Conakry |
| | Ivory Coast | Sharp cutbacks in public-sector spending could lead to real GDP contraction. | June '80 | + 21% | 10.5 | 1,312 | Jan. | 27 | − 48% | 0.1 | 87 | Higher debt interest payments may widen current-account gap. | Jan. | + 17% | Aug. | + 2% | .00351 | −28% | Liquidity extremely tight. | Ivory Coast |
| | Kenya | Import restraint affecting economic output. | Dec. | − 6% | 7.1 | 440 | Apr. | 422 | − 36% | 2.6 | 215 | Foreign-exchange shortage causing payments delays. | Mar. | + 10% | Feb. | 0 | .1275 | − 7% | Credit tightness continues. | Kenya |
| | Libya | Government expenditure on infrastructure, power projects, and hydrocarbon sector rising. | Feb. | + 6% | 23.0 | 8,050 | Apr. | 13,074 | + 47% | 17.0 | 0 | Oil output down to 1.1 million bpd from 1.6 million bpd in March. | n. a. | — | Dec. '79 | + 33% | 3.41 | + 1% | Credit generally available. | Libya |
| | Morocco | Growth rate in 1981 to be adversely affected by a drought-induced drop in farm output. | Dec. | + 14% | 15.3* | 788 | Mar. | 423 | + 27% | 1.2 | 395 | Phosphate rock prices holding steady. | Jan. | + 10% | Feb. | + 8% | .1900 | −27% | Claims on government rising rapidly. | Morocco |
| | Nigeria | Forecast $2.5-billion budget gap has serious implications for project execution. | Feb. | + 23% | 77.0 | 950 | Mar. | 9,728 | + 49% | 10.1 | 0 | Lower oil output and prices imply $3-billion+ current-account gap in 1981. | Sept. | + 9% | Aug. | + 15% | n. a. | — | Preferential credits for agriculture find few takers. | Nigeria |
| | Senegal | Real GDP decline of 6% in 1930 likely to be followed by 5% decline this year. | n. a. | — | 2.9 | 513 | Jan. | 11 | − 60% | 0.2 | 88 | Oil import bill likely to reach $200 million this year. | Feb. | + 2% | Aug. | + 7% | .00351 | −28% | Liquidity very tight. | Senegal |
| | South Africa | First-quarter real economic growth rate slows to 4.5% from 8% last year. | Mar. | + 4% | 80.2 | 2,725 | Apr. | 807 | + 19% | 0.4 | 0 | Weak gold prices and rising imports widen trade gap. | Mar. | + 16% | Jan. | + 46% | 1.13 | −13% | Interest rates continue to climb. | South Africa |
| | Tanzania | Large-scale fertilizer plant to be built, utilizing natural gas as feedstock. | June | − 9% | 6.0 | 325 | Feb. | 15 | − 85% | 0.2 | 94 | New export incentives to take effect July 1. | Dec. | + 36% | Nov. | + 28% | .1235 | + 1% | External arrears increase substantially. | Tanzania |
| | Tunisia | State outlays on development schemes accelerating. | Dec. | + 11% | 7.1* | 1,135 | Apr. | 520 | + 17% | 1.7 | 0 | Tourist arrivals from W. Europe down in first quarter. | Dec. | + 10% | Feb. | + 19% | 2.04 | −20% | World Bank lends $41.5 million for electric power project. | Tunisia |
| | Uganda | IMF grants $130-million one-year standby to support economic stabilization program. | n. a. | — | 8.0 | 600 | Dec. | 17 | − 26% | 0.8 | 45 | Transport, finance problems preclude filling ICO coffee export quota. | n. a. | — | Nov. | + 41% | n. a. | — | Shilling devalued 90%. | Uganda |
| Middle East | Iraq | State outlays on civilian development projects expanding steadily. | Feb. | − 66% | n. a. | — | n. a. | — | — | — | 0 | Oil output averaged 960,000 bpd in March, versus 400,000 bpd in Jan. | n. a. | — | — | — | 3.41 | 0 | Kuwait lends government $2 billion. | Iraq |
| | Kuwait | Hydrocarbon sector and infrastructure to receive priority in the 1981-82/1985-86 development plan. | Feb. | − 5% | 27.3 | 19,870 | Feb. | 3,713† | + 41% | 7.1 | 0 | Oil output ceiling cut from 1.5 million bpd to 1.25 million April 1. | Dec. | + 9% | Feb. | + 15% | 3.5525 | − 5% | Credit to private sector rising steadily. | Kuwait |
| | Qatar | Government discussing development of large North West Dome gas field with several companies. | Feb. | + 25% | 3.2 | 15,214 | Sept. | 385† | n. a. | 3.6 | 0 | Oil output reported cut to 400,000 bpd from 500,000 bpd on June 1. | n. a. | — | Sept. | + 9% | .2765 | + 1% | Money supply rising steadily. | Qatar |
| | Saudi Arabia | Rising oil exports and state outlays sustain economic expansion. | Feb. | + 52% | 117.6 | 19,500 | Apr. | 27,184† | + 38% | 11.4 | 0 | War-relief oil export sales of 450,000 bpd to end July 1. | Dec. | + 2% | Oct. | + 14% | .2945 | − 2% | Riyal devalued to 3.41 per dollar. | Saudi Arabia |
| | United Arab Emirates | Industrial bank to be set up in Abu Dhabi to finance private-sector UAE projects. | Feb. | + 22% | 16.0* | 19,275 | Apr. | 2,353† | + 65% | 3.3 | 0 | Abu Dhabi oil output averaged 1.24 million bpd in IQ, down 9% from IQ '80. | n. a. | — | Feb. | + 8% | .2735 | + 1% | Reserve ratio of 15% on offshore loans in local currency. | United Arab Emirates |

*1979 †Excluding state reserves

# World Interest Rates

*market rates of June 30, 1981; bond yields as of June 26, 1981*

| in percent per annum | U.S. | Canada | Britain | Belgium | France | Germany | Italy | Netherlands | Switzerland | Japan |
|---|---|---|---|---|---|---|---|---|---|---|
| **Central Bank Discount Rate** | 14.00 penalty-large banks 18.00 | 19.08 | 12.00 | 13.00 | 9.50 | 7.50 | 19.00 penalty rate 22.00 | 9.00 | 5.00 | 6.25 |
| **Day-to-Day Money** | 19.50 July 1 | 18.50 | 11.50 | 8.10 | 19.00 | 12.00 | 20.125* | 11.75 | 4.00 | 7.375 |
| **Treasury Bills** 91-day, Middle Rates | 14.28 | 18.85 | 11.9375 | 14.75 | n. a. | n. a. | 18.65* 98-day | no dealing | no market | 5.625 two-month |
| **Commercial Paper** prime, 3-month, asked | 15.00 finance paper | 19.25 finance paper 15% tax w/h | 11.46 | 12.90 Certified | 18.125 Interbank | no market | no market | no market | no market | not traded |
| **Bankers' Acceptances** 3-month, asked | 16.00 | 19.25 15% tax w/h | 12.00 | 12.90 Certified | not traded | 9.90 | 23.40* | no market | 10.00 | no market |
| **Government Bonds** Long-term, new and old issues, average yield | 13.42 | 15.90 | 14.36 | 10.5515 20% tax w/h | 16.57 | n. a. | 19.99* | 11.35 | 5.62 | 8.181 |
| **Industrial Bonds** prime, long-term, new and old issues, average yield | 14.40 Aa Industrials | 16.25 | 15.31 | 15.596 | 17.98 | n. a. | 21.21* | 12.84 | 6.325 | 7.20 |
| **Bank Short-Term Rate** to Best Borrowers (prime rate) | 20.00 | 20.00 | 13.00 | 18.25 | 20.60 | 14.50 | 22.50* ⅛ quar'ly fee on outstdng. | 13.50 | 9.50 | 6.75 |
| **Bank Time Deposits** 3-month | 16.375 Cert. of Dep. | 19.25 | 12.50 | 15.10 | 18.25 | 12.80 | 10.75* | 11.875 large deposits | 9.00 residents only | 4.25 20% tax w/h |
| **Eurocurrencies** 3-month, asked | 17.9325 | no market | 12.75 | no market | 24.50 | 12.4375 | no market | 11.875 | 10.00 | no market |
| **Exchange Rates—in U.S.$** rates floating against the $ | — | .8324 | 1.9235 | .025475 | .1745 | .4175 | .000855 | .3752 | .4865 | .004390 |
| **Forward Exchange Cover** 3-month, in percent p.a. *D* = discount, *P* = premium | — | 1.375 *D* | 5.375 *P* | .375 *P* | 5.25 *D* | 5.375 *P* | 6.4957 *D* | 6.00 *P* | 7.875 *P* | 10.375 *P* |

**Eurodollar Deposits**
(London, interbank, bid)
June 30

| | |
|---|---|
| 7-day | 18.50 |
| 1-month | 18.125 |
| 3-month | 17.8125 |
| 6-month | 17.3125 |

**International Arbitrage**
(3-month, hedged) + *in favor of U.S. dollars*

| | |
|---|---|
| U.S.-U.K. Treasury Bills | −2.869 |
| U.S.-Canada Treasury Bills | −2.35 |
| U.S.-Canada Finance Co. Paper | −2.86 |
| Eurodollars-U.K. Local Auth. Deposits | −0.375 |

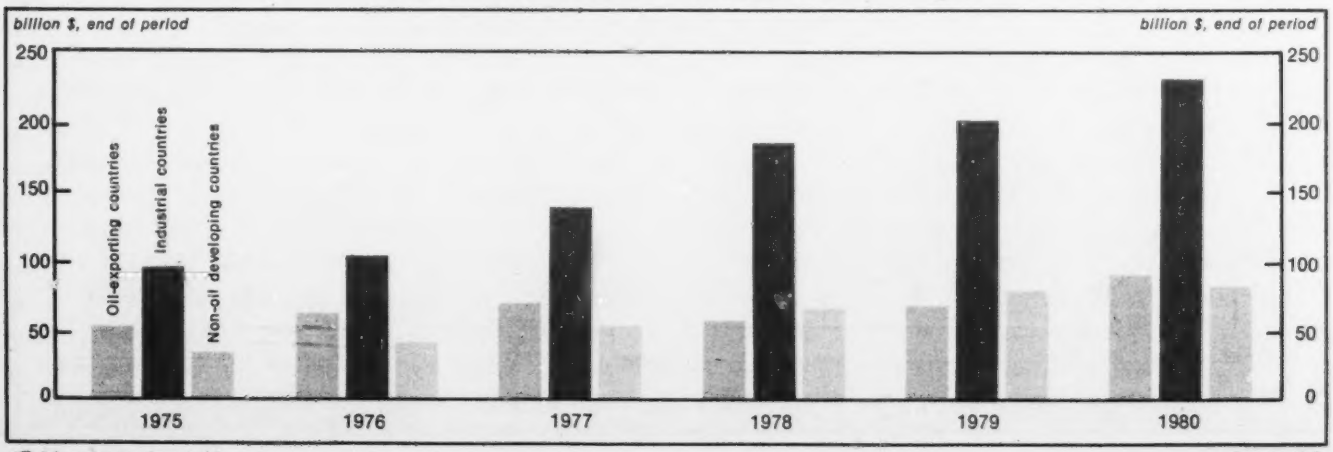
**Eurobonds**
(average yield on recent straight debt issues)

| | |
|---|---|
| U.S. Dollar Bonds | |
| 7 yrs. and under | 15.375 |
| Over 7 yrs. | 15.25 |
| DM Bonds | |
| 7 yrs. and under | 11.00 |
| Over 7 yrs. | 10.625 |

**Gold Price**
London afternoon fixing
426.00
(per fine ounce)

**The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.**
*** Market rates as of June 24; bond yields as of June 19.**

## Trends in international reserve holdings*




*Total reserves minus gold

Source: IMF

# Shifts in World Payments Imbalances

Current indications are that the combined surplus of the Organization of Petroleum Exporting Countries (OPEC) will decline significantly from last year's $110 billion (see June 22 issue). Oil prices for 1981 as a whole seem likely to average 10%-13% more than in 1980, a full 10 percentage points less than was projected at the beginning of the year. Oil consumption, particularly in the industrialized countries, has continued to decline, and total demand for OPEC oil in 1981 will apparently fall as much as 11% below last year's level. With imports continuing to grow rapidly, the combined surplus of the OPEC members for 1981 now seems likely to total at least $30 billion less than in 1980. And if political upsets in the Middle East can be avoided, a further decline of $15-$20 billion in the OPEC surplus is probable in 1982.

The projected shrinkage of the OPEC surplus raises the question of where offsetting improvements in international payments imbalances are likely to emerge. The preliminary answer—summarized in the table below—is not very satisfying. These "bottom-up" forecasts—that is, estimates obtained by aggregating the projected payments imbalances of individual countries—project a decline in the OPEC surplus that is markedly larger than the estimated improvement in the current-account position of the rest of the world. The sum of the estimated payments deficits for 1981 and 1982 in the table below exceeds the sum of estimated payments surpluses by more than $50 billion. If the accounts of excluded countries, principally South Africa and Israel, are considered, the statistical discrepancy approaches $60 billion, more than double the unexplained residual embedded in the balance-of-payments numbers now available for 1980. Although large year-to-year increases in this discrepancy are not without precedent, the suspicion remains that something is wrong. Either the OPEC surplus will turn out to be larger than forecast, or the improvement in the international payments position of the oil importing countries is understated. The betting here is that the latter is much more likely.

**Current-Account Balances**
(billion $, including official transfers)

| | 1980 | 1981 est. | 1982 proj. |
|---|---|---|---|
| United States | 3 | 2 | − 2 |
| Japan | −11 | − 3 | 3 |
| EEC | −41 | −30 | −20 |
| OECD | −77 | −60 | −45 |
| OPEC | 110 | 80 | 63 |
| Other Developing Countries | −52 | −59 | −60 |
| Centrally Planned Economies | − 7 | −12 | −13 |

It does not appear likely, however, that current projections significantly overestimate the deficit on current account of the (non-OPEC) developing countries as a group. Although the less-than-expected increase in oil prices will save oil-importing developing countries some $7 billion this year, it will cost those (non-OPEC) developing countries that are oil exporters roughly $2 billion in foregone export earnings. Further, commodity prices have averaged significantly lower and interest rates markedly higher than was expected at the beginning of the year. With the *net* indebtedness of the non-OPEC developing nations to international commercial banks now over $100 billion, the worsening of the payments deficit associated with the latter effect alone will apparently exceed $2 billion. Thus, although the total payments deficit of the non-OPEC developing countries for 1981 may prove slightly smaller than forecast earlier, the conclusion remains that this deficit will be moderately larger in nominal terms this year than last, mainly because of the relatively slow growth of markets for developing-country exports in the industrialized nations. And although the more rapid growth projected for the industrialized countries next year implies both an improvement in commodity prices and a more rapid growth of developing-country export volume, it is difficult to forecast a drop in the current-account deficit of the (non-OPEC) developing countries in 1982.

The improvements in international payments imbalances offsetting the declining OPEC surplus will thus accrue mainly to the industrialized countries. The United States appears to be a conspicuous exception to this tendency, however. This year, the favorable effects of lower-than-expected oil prices have been offset by higher-than-expected economic growth and, hence, increased non-oil imports. Next year, the lagged effect of dollar appreciation will contribute to a worsened trade balance, although this shift could be overwhelmed by improved earnings of U.S. business overseas.

The most significant improvements in current-account position this year and next seem likely to be registered by Japan and the European Economic Community (EEC) countries. A sizable fall in the Japanese current-account deficit has been widely forecast; the change projected here may well be underestimated, despite the increased foreign political resistance to the continued growth of Japanese exports. There is considerably less consensus as to the balance-of-payments outlook for Europe. Despite the European recession, most analysts have tended to project a relatively modest decline in the EEC current-account deficit for 1981, largely because of concern for the "J-curve" effect of dollar appreciation. Recent data on exports and export orders suggest a more significant improvement, however. If current projections of this year's OECD current-account deficit prove too pessimistic, the bulk of the unexpected improvement will likely accrue to the EEC countries.

# Investment to Spur New Zealand Growth

On the strength of stepped-up capital investment, New Zealand's economy appears poised to break out of the sluggish real economic growth path it has followed for the past few years. Real GDP growth, which is estimated at just 1% in fiscal 1980-81 (ended last March), is projected to rise to 2% in the current fiscal year and further to 3% in fiscal 1982-83.

The 1% real growth recorded last fiscal year was attributable mainly to an increase in net inflation-adjusted exports. Export volume advanced 5%, while import volume fell 6%. At the same time, real domestic demand actually declined about 2%. Agriculture and food processing turned in the strongest performances, owing to good weather.

The outlook for economic growth in the current fiscal year and in fiscal 1982-83 is notably brighter. Indeed, the period of stop-go growth with no increase in real per capita income may have now ended. The main reason is increased investment spending on a series of major industrial projects. These include an oil refinery expansion, aluminum smelter development, petrochemical projects, and, possibly, ethanol, methanol-to-gasoline, and steel projects. These projects—some already under way—are expected to boost fixed investment in real terms by some 10% in fiscal 1981-82. The investment boom will likely continue into fiscal 1982-83 and beyond, provided that the go-ahead is given to most of the projects under consideration. Inflation-adjusted consumption growth is also expected to accelerate, although a deterioration in the real external balance is likely to dampen GDP growth.

The double-digit pace of consumer price inflation, however, is expected to continue high. The inflation rate averaged near 17% in fiscal 1980-81, up from 13.8% in 1979-80. The pace of price increase is expected to ease only slightly this year, to an estimated 16%, and to some 15% in fiscal 1982-83, because of the system of informal wage indexation, the expectation of further depreciation of the exchange rate, and faster money growth.

New Zealand government policy was rather restrictive in fiscal 1980-81. Government consumption spending was held constant in real terms, capital spending fell 10%-12%, and the public deficit was kept to 5.3% of GDP, the same as in the previous year. In its November mini-budget, the government did cut income taxes 5.5% effective February 1 and took other stimulative measures to bolster the weak domestic economy. Nevertheless, a relatively neutral fiscal stance is expected for the next two fiscal years, the aim being to hold aggregate demand at its current level until the private-investment-led recovery takes hold.

New Zealand's surplus on trade account is estimated to have increased somewhat in 1980-81, to $474 million from $377 million in 1979-80. Export volume jumped as a result of agriculture's very strong showing, while import volume dropped as a result of drawdowns of stocks and little output growth in the more import-intensive manufacturing sector. The deficit on net invisibles increased as a result of higher interest payments on debt, but the modest improvement on trade account permitted a slight narrowing in the current-account gap to approximately $740 million from $772 million in 1979-80.

The balance-of-payments outlook for New Zealand over the next several years is uncertain. It depends on the price trends of New Zealand's exports and imports, its ability to obtain access to U.S., Australian, and European Community markets, and its success in diversifying its exports and markets. Although New Zealand has had some success in export diversification, the swing toward heightened protectionism in world trade is worrisome. Moreover, despite the country's abundance of natural gas, coal, and hydroelectricity, it still counts on imported oil to satisfy its liquid fuel needs, and is thus subject to the whims of OPEC.

More significantly, the investment projects already under way or planned will boost imports sharply. This, combined with the large increase in interest payments associated with mounting external debt, will result in a worsening trade and current-account balance. Large inflows of capital to finance the deficits will, however, help offset this deterioration. And when the projects go into operation, the trade and current-account balances should improve as the output generated by some of these projects (e.g., methanol, urea) is exported. In addition, if the synthetic gasoline project is undertaken—and is successful—oil imports could be reduced significantly in the latter half of the 1980s.

Thus, although the longer-term external-account outlook is for improvement, the nearer-term outlook is bearish. For fiscal 1981-82, the trade balance is projected to narrow to $450 million, while the current-account gap is forecast to widen to $900 million. In fiscal 1982-83, the trade balance is likely to approximate its showing in 1981-82, but a large rise in interest payments will expand the current-account gap further to $1.1 billion.

Financing these deficits with capital inflows, however, should prove no problem. Although external debt has risen rapidly since the mid-1970s, New Zealand's sound creditworthiness and the productive nature of its borrowing should create no difficulty in obtaining the needed capital and in managing the additional debt.

*Melanie L. Lau*